'Go-Go' Setback: Some 'Growth' Funds Show Only Small '68 Gains

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formance that shareholders should think most about, many are now arguing, rather than results in any one year.

"People are too short-term oriented," complains William O'Neil head of the $40 million O'Neil Fund. "Everybody gets the idea you should be up 100% every year, but I'm happy after a good year just to break even in a slow year. The great potential in growth funds is over a four or five-year period." Mr. O'Neil's fund recorded a 115% gain in net asset value last year, but two weeks ago was up only 0.25% for 1968; the market's sharp rally since has lifted its 1968 gain to about 8% currently.

In a letter to dealers who sell Manhattan Fund shares, Mr. Tsai last week similarly complained that shareholders "are comparing results of Manhattan Fund with smaller speculative funds or even individual securities" and said Manhattan Fund had been unable to satisfy their "extremely ambitious goal." He likened the battle among funds to outdo each other to "an auto race in which the lead changes hands many times, and some cars go to the pits, never to return. The winner is determined only after a long and grueling run."

Some brokers and analysts suspect, however, that the troubles many of the performance funds have encountered in 1968 may prove to be no one-year fluke but rather the first manifestation of a serious long-range problem. In their view, this year's record indicates that some of the better-known growth funds have become, in effect, financially muscle-bound. The funds have attracted so much money from eager investors, say these observers, that they are now too big to move as nimbly from one group of stocks to another as they must if they are to keep recording the big gains their shareholders have come to expect.

Smaller Funds Shine

As evidence, these analysts cite statistics indicating that those growth funds that have scored dramatic gains this year generally have been the smaller ones. Only two growth funds with assets of $100 million or more have made the list of the top 40 mutual-fund performers so far this year (they are Enterprise Fund, with a 45.4% gain in net asset value, and Putnam Equities, with a 42.4% gain). Smaller funds are more numerous among the big gainers, and Mates Investment Fund, with only $24 million of assets, topped the list with a spectacular 167% gain.

To Charles D. Ellis, vice president of Donaldson, Lufkin & Jenrette, a brokerage firm serving institutional investors, such statistics suggest that growth funds "can get too big for their own kind of game." He and others believe that bigness can confine some funds to investments in companies that have large numbers of shares outstanding, even though these may not be the companies whose stock has scored the largest gains.

"It's easy for a big fund to put 5% of its money into IBM," which has 112 million shares outstanding," says one broker. (IBM is one of the traditional growth-fund favorites that has been declining in price for portions of this year.) "It's a lot harder to put even a smaller percentage into a Mohawk Data Sciences (an American Stock Exchange issue that has scored sharp price gains earlier this year), which has only five million shares outstanding."

Concentrated buying by a big mutual fund in a company with such a small capitalization, brokers note, would send the price soaring. Worse, if the mutual fund later decided to get out, its selling could depress the price disastrously.

Most growth-fund managers don't buy this argument. To begin with, growth-fund managers disagree with one another on whether it would be advisable to invest in some of the small-capitalization companies that have been scoring big price gains, even if they could do it easily.

Mr. Tsai says Manhattan Fund, in a policy shift, now aims to invest in "not only better-known growth stocks but also some smaller-capitalized situations." But Thomas Martin, president of the Channing Group of funds, which includes Channing Growth Fund, believes it could be dangerous to invest too heavily in small-capitalization companies. He thinks some of these are of dubious long-term investment merit—to put it mildly.

"It would be disastrous for a large growth fund suffering in performance for nine months to move back into the 'garbage' game," says Mr. Martin. "We've known the 'junk' market has been doing well this year, but we don't think it's appropriate to take our fund into it."

Other fund men point out that some of the biggest growth funds have been doing reasonably, if not spectacularly, well. Dreyfus Fund, with $2.5 billion of assets, for instance, has scored a 14% gain in net asset value so far this year, slightly outperforming the average of all New York Stock Exchange common shares. Many analysts think that whatever inflexibility the poorer-performing funds have displayed has resulted not from size but from an overattachment to the glamor issues of past years. They also assert that the funds have shown a prejudice against stocks traditionaly considered staid that nevertheless have been outperforming the computer and conglomerate issues this year.

Disdaining a "Crutch"

"The problem of size could be a great crutch to fall back on" to explain away lackluster performance, says Robert Doran, one of the founders of Ivest Fund. "But as long as there are funds larger than ourselves doing well, I don't think we can point to size as the problem." Rather, he blames Ivest's drop in net asset value earlier this year on a "temporary inflexibility" in investment policy. Lately, he says, "we've turned ourselves inside out" to correct the situation.

In the six months ended Aug. 31, Ivest reduced its holdings of such conglomerate companies as Penn-Central Co., Whittaker Corp., Teledyne Inc. and Susquehanna Corp. and of such computer makers as Sperry Rand Corp. and Control Data Corp. Recently it has been making substantial purchases of utility, airline and insurance stocks, says Mr. Doran, and as a result "we've been coming back up at an accelerating rate in the last couple of months."

Growth funds that made similar switches earlier have done much better. Kenneth Pash, 30-year-old portfolio manager of Putnam Equities, credits his fund's 42% gain in net asset value so far in 1968 largely to a decision to reduce its holdings of computer and electronics issues late last year and to make heavy purchases of housing and finance-related stocks in this year's first quarter.